

CONSERVATION EASEMENTS FOR PRODUCTIVE FORESTLANDS: Financial Incentives for Forest Protection

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Abstract: Non-industrial forestland owners (NIPFs) face particular financial barriers to long-term forest stewardship and management of non-commodity forest resources. Conservation easements (CEs) can provide financial incentives to overcome these barriers. They are a rare opportunity for NIPFs to be rewarded for voluntarily restricting non-forest uses or modifying silviculture to benefit non-timber forest resources, including habitat, water quality and carbon storage. While retaining fee title, landowners sell or donate CEs to qualified non-profit organizations or government agencies. The landowner receives revenue and/or tax benefits for the value of the restrictions placed on the property's deed. CEs are especially useful in maintaining forestland through the estate process, avoiding premature or excessive harvest, subdivision or liquidation of the property. There is increasing use of CEs by landowners in the Redwood Region. This trend may be driven by the combination of high timber and development values. These values increase the need for landowners to do proper succession planning for their property.

What Incentives Exist for NIPFs in Their Forest Stewardship Efforts?

Numerous hurdles lie in the way of NIPFs achieving long-term forest stewardship. The primary ones are:

- Lack of capital or financing for forest investments, such as stand improvement, resource conservation, road maintenance, and planning.
- Lack of knowledge of forestry and access to technical resources.
The time value of money, especially considering the growth period required for many major species (especially redwoods) to attain high quality age classes and biological maturity.
- Lack of income between timber harvests; lack of diversified income from the property.

There exist various kinds of incentives to help NIPFs in their efforts to overcome these hurdles and accomplish their forest stewardship goals. Some incentives are financial in nature and others are not. The following summarizes available incentives:

Educational outreach and technology transfer
Cost share programs for forest stand improvements and resource conservation

- Regulatory streamlining, e.g., Non-Industrial Timber Management Plans.
- Market development and access programs
- Conservation easements

Conservation Easements: Effective Existing Incentives

While the first conservation easement is reported to have been placed by Frederick Law Olmstead on a Boston park in the 1880s, they have been in regular use since the thirties. Land trusts manage more than 750,000 acres under conservation easements in the United States today. Most conservation easements have been placed in the last twenty years since the Internal Revenue Code was amended to explicitly provide for the deductibility of gifts of qualified conservation easements.

Through the sale or charitable donation of a conservation easement by a landowner, they are compensated for their voluntary commitment to conservation. Conservation easements are attractive land conservation tools because this approach maintains private ownership and control of the property, rather than requiring its sale. While most conservation easements have been utilized to protect open space (typically farmland), habitat set asides or scenic views, the use of conservation easements on working forestland is a relatively recent and growing phenomena.

Conservation easements are appealing to NIPFs because they can help protect carefully stewarded forest capital from liquidation through unwanted over harvesting and parcelization of the property. By limiting land uses to compatible forest uses and by restricting the rate and character of timber harvest, the reduced appraised property value can help NIPFs keep the forestland in the family through reducing estate taxes.

With the ownership of property comes the right to do, or not do, many things: develop new lots, build residential and other structures, utilize water, farm, harvest timber, etc. Most landowners are protective of their property rights and desire to maintain their options for a range of land uses. Others wish to maintain the ability to utilize their land as they are already doing. The right to limit development on land has been called by some the "Lost Property Right." Landowners can utilize conservation easements to protect their forest assets by stripping off speculative rights that raise their taxes but provide no

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income. All rights not restricted by them in the easement are available for use, balancing conservation with economic gain.

What is a Conservation Easement, Exactly?

A conservation easement is a permanent deeded restriction voluntarily placed on the forestland by the landowner. Its terms define and limit the kind of development and use that can take place on the property. The purpose of the CE is specifically defined for each property but, generally, must allow for the protection of certain natural values that have been identified as having public benefit, such as open space or fish and wildlife habitat. The landowner grants the easement to a government entity or nonprofit land trust to monitor and enforce through time. The grantee organization has the responsibility to ensure that the restricted rights are not exercised but are "held in trust" for the public. Conservation easements are distinguished from regulation because they establish standards of management above and beyond those required by law. Further, unlike regulation, conservation easements are not one-size-fits-all.

Most conservation easements are granted by landowners to charitable non-profit conservation organizations known as "land trusts" or "land conservancies." Their primary purpose is to privately serve landowners' conservation objectives, becoming a partner in ensuring that their vision of forest stewardship continues in perpetuity.

How is a Conservation Easement Established?

When a landowner approaches a land trust about establishing a conservation easement a process of mutual research, analysis and goal setting ensues. Together the landowner and land trust jointly review the subject property's significant characteristics and identify the specific "conservation values" that are considered of public benefit and warranting protection through a conservation easement. Based on this, a general conservation plan is devised, reflecting the landowner's goals for management and conservation of the property's resources. The actual terms of the legal deed of conservation easement are derived from the conservation plan. At the same time, a "baseline report" is researched and written, documenting the property's characteristics at the time the easement is being granted. This becomes the point of reference against which future easement monitoring is compared. When the deed of conservation easement is agreed to by both parties, it is signed and recorded in the county where the property is located. From that point on, the grantee land trust carries the liability of monitoring and enforcing the terms of the easement on behalf of the grantor. To fund this obligation, typically the granting landowner makes a provision for a contribution to a stewardship fund, the earnings from which offset the annual monitoring expenses of the land trust.

Qualifications for Tax Deductibility

Conservation easements are the only gift of partial interest in property that can be tax deductible. For the donation of a conservation easement to qualify, the IRS has established certain standards in Section 170(h) of the Internal Revenue Code. According to these, the conservation easement must meet one or more conservation benefit tests of particular relevance to forestland. The terms of the easement must restrict land use to:

- Protect habitats or ecosystems; and/or
- Preserve open space pursuant to government policy or for scenic enjoyment of the general public.

Conservation easements can also be given to provide for public education or recreation, or to protect historic sites. Further, the conservation easement must be donated to a qualified nonprofit 501(c)(3) land trust or government agency, and the easement must be in perpetuity.

There are other provisions of the Code and the relevant Treasury regulations that NIPFs should know about in considering the establishment of a conservation easement on their property. Landowners should consult with their legal and tax advisers to receive professional advice in their consideration.

Typical Provisions of a Conservation Easement

Conservation easements on working forestland will typically contain provisions that prohibit non-forest uses and also guide on-going forest management to ensure that the conservation values of the property are protected. In general, such a conservation easement will:

- Dedicate the property to compatible forest uses;
- Limit or prohibit subdivision or parcelization;
- Prohibit residential development or limit its scale and impact on the forested areas of the property;
- Restrict timber harvesting to meet resource conservation goals, e.g., protection of riparian habitat, enhancement or restoration of habitat, water quality improvements, etc.; and
- Protect other identified "public benefit" resources mutually agreed upon, e.g., scenic or recreation values.

Compensation for Conservation

Each conservation easement is valued through an independent appraisal. Based on that value, the granting landowner receives either income or income tax benefits as well as a reduction in the value of their estate and therefore, estate taxes. The CE value represents the "opportunity cost" to the landowner of the terms of forest protection he has created in the easement, including deferred harvest, foregone development rights, or habitat preservation.

Conservation Easements Can Reduce or Eliminate Estate Taxes

NIPFs cite the impact of estate taxes on their forestland as one of their greatest concerns. Often the heirs to forestland are compelled to prematurely or excessively harvest their timber, or sell their property, to meet the estate tax obligation. In the settlement of an estate, the IRS appraises forestland at its greatest liquidation value or "highest and best use," not its current forest use. Highly appreciated timber and trees are valued as if they were to be completely sold in an orderly fashion. This form of valuation can unexpectedly place many redwood region NIPF families in a high estate tax bracket.

By having placed a CE on the family forestland, the NIPF reduces the estate value by eliminating development rights that he or she doesn't intend to utilize. The estate's forestland is then valued only for its forest uses. CEs can be used in combination with most estate planning tools to maximize benefits and "zero out" estate taxes.

An Example from the Redwood Region on the Use of a Conservation Easement

Two sisters in their sixties own 1000 acres of coastal redwood forestland. It was purchased by their parents in the forties and since then both timber and land values have appreciated greatly. This property represents their largest single asset. The average stocking is 20,000 bf/acre, and there are 8 underlying parcels comprising the property. The sisters' property management goals are for periodic

income, family recreation, and the maintenance of one residence.

Together the family determines that the CE should prohibit subdivision, more building and clearcutting of the property. They want to maintain harvesting timber at about the same level they have been, so they limit timber harvest to 20% of inventory per decade. They also want to protect the salmon stream on the property and enhance forest structure for habitat, so they add some restrictions relating to riparian zones, steep slopes and maintenance of snags and woody debris.

The "Before" value of the property is appraised at \$13 million (\$1 million in land and \$12 million in timber). Taking into consideration the effect of the conservation easement, the "After" value is determined to be \$5.5 million (\$500,000 in land and \$5,000,000 in timber). Therefore, the reduction in the estate appraisal will be \$7.5 million and the corresponding reduction in estate taxes is \$3.5 million. The remaining estate tax payable of \$2.5 million can then likely be met through the restricted timber harvest.

For the two sisters, the gift of the \$7.5 million conservation easement to a land trust provides a major charitable income tax deduction as well. This charitable tax deduction could be applied against up to 30% of their adjusted gross income and can be carried forward five years. If the donation is made in their lifetime and is timed well, it can be applied against timber harvest receipts or any income.